

the period of the taxpayer's ownership and use of the property under section 121 the taxpayer may include the periods that the taxpayer owned and used the section 1034 property as the taxpayer's principal residence (and each prior residence taken into account under section 1223(7) in determining the holding period of the section 1034 property).

(i) [Reserved]

(j) *Election to apply regulations retroactively.* Taxpayers who would otherwise qualify under §§ 1.121-1 through 1.121-4 to exclude gain from a sale or exchange of a principal residence before December 24, 2002 but on or after May 7, 1997, may elect to apply §§ 1.121-1 through 1.121-4 for any years for which the period of limitation under section 6511 has not expired. The taxpayer makes the election under this paragraph (j) by filing a return for the taxable year of the sale or exchange that does not include the gain from the sale or exchange of the taxpayer's principal residence in the taxpayer's gross income. Taxpayers who have filed a return for the taxable year of the sale or exchange may elect to apply the provisions of these regulations for any years for which the period of limitation under section 6511 has not expired by filing an amended return.

(k) *Audit protection.* The Internal Revenue Service will not challenge a taxpayer's position that a sale or exchange of a principal residence occurring before December 24, 2002 but on or after May 7, 1997, qualifies for the section 121 exclusion if the taxpayer has made a reasonable, good faith effort to comply with the requirements of section 121. Compliance with the provisions of the regulations project under section 121 (REG-105235-99 (2000-2 C.B. 447)) generally will be considered a reasonable, good faith effort to comply with the requirements of section 121.

(l) *Effective date.* This section is applicable for sales and exchanges on or after December 24, 2002. For rules on electing to apply the provisions retroactively, see paragraph (j) of this section.

[T.D. 9030, 67 FR 78361, Dec. 24, 2002; 68 FR 6350, Feb. 7, 2003]

§ 1.121-5 Suspension of 5-year period for certain members of the uniformed services and Foreign Service.

(a) *In general.* Under section 121(d)(9), a taxpayer who is serving (or whose spouse is serving) on qualified official extended duty as a member of the uniformed services or Foreign Service of the United States may elect to suspend the running of the 5-year period of ownership and use during such service but for not more than 10 years. The election does not suspend the running of the 5-year period for any period during which the running of the 5-year period with respect to any other property of the taxpayer is suspended by an election under section 121(d)(9).

(b) *Manner of making election.* The taxpayer makes the election under section 121(d)(9) and this section by filing a return for the taxable year of the sale or exchange of the taxpayer's principal residence that does not include the gain in the taxpayer's gross income.

(c) *Application of election to closed years.* A taxpayer who would otherwise qualify under §§ 1.121-1 through 1.121-4 to exclude gain from a sale or exchange of a principal residence on or after May 7, 1997, may elect to apply section 121(d)(9) and this section for any years for which a claim for refund is barred by operation of any law or rule of law by filing an amended return before November 11, 2004.

(d) *Example.* The provisions of this section are illustrated by the following example:

Example. B purchases a house in Virginia in 2003 that he uses as his principal residence for 3 years. For 8 years, from 2006 through 2014, B serves on qualified official extended duty as a member of the Foreign Service of the United States in Brazil. In 2015 B sells the house. B did not use the house as his principal residence for 2 of the 5 years preceding the sale. Under section 121(d)(9) and this section, however, B may elect to suspend the running of the 5-year period of ownership and use during his 8-year period of service with the Foreign Service in Brazil. If B makes the election, the 8-year period is not counted in determining whether B used the house for 2 of the 5 years preceding the sale. Therefore, B may exclude the gain from the sale of the house under section 121.

(e) *Effective date.* This section is applicable for sales and exchanges on or after May 7, 1997.

[T.D. 9152, 69 FR 50306, Aug. 16, 2004]

§ 1.122-1 Applicable rules relating to certain reduced uniformed services retirement pay.

(a) *Rule applicable prior to January 1, 1966.* In the case of a member or former member of the uniformed services of the United States (as defined in 37 U.S.C. 101(3)) who has made an election under Subchapter I of Chapter 73 of Title 10 of the U.S. Code (also referred to in this section as the Retired Serviceman's Family Protection Plan (10 U.S.C. 1431)) to receive a reduced amount of retired or retainer pay, gross income shall include the amount of any reduction made in his retired or retainer pay before January 1, 1966, by reason of such election, unless such reduction, or portion thereof, is otherwise excluded from gross income under Part III of Subchapter B of Chapter 1 of the Internal Revenue Code of 1954 or any other provision of law.

(b) *Rule applicable after December 31, 1965—*(1) In a case of a member or former member of the uniformed services of the United States (as defined in 37 U.S.C. 101(3)), gross income shall not include the amount of any reduction made in his or her retired or retainer pay after December 31, 1965, by reason of—

(i) An election made under the Retired Serviceman's Family Protection Plan (10 U.S.C. 1431), or

(ii) The provisions of Subchapter II of Chapter 73 of Title 10 of the U.S. Code (also referred to in this section as the Survivor Benefit Plan (10 U.S.C. 1447)).

(2)(i) In a case where a member or former member of the uniformed services has, pursuant to the election described in paragraph (a) of this section, received before January 1, 1966, a reduced amount of retired or retainer pay, he shall, after December 31, 1965, exclude from gross income under section 122(b) and this subdivision all amounts received as uniformed services retired or retainer pay until there has been so excluded an amount of retired or retainer pay equal to the "consideration for the contract" (as

described in subdivision (iii) of this subparagraph).

(ii) Upon the death of a member or former member of the uniformed services, where the "consideration for the contract" (as described in subdivision (iii) of this subparagraph) has not been excluded in whole or in part from gross income under section 122(b) and subdivision (i) of this subparagraph, the survivor of such member who is receiving an annuity under Chapter 73 of Title 10 of the U.S. Code shall, after December 31, 1965, exclude from gross income under section 72(o) and this subdivision such annuity payments received after December 31, 1965, until there has been so excluded annuity payments equalling the portion of the "consideration for the contract" not previously excluded under subdivision (i) of this subparagraph.

(iii) The term "consideration for the contract" as used in this subparagraph means—

(a) The total amount of the reductions, if any, before January 1, 1966, in retired or retainer pay by reason of an election under Subchapter I of Chapter 73 of Title 10 of the United States Code, plus

(b) The total amount, if any, deposited by the serviceman at any time pursuant to the provisions of sections 1438 or 1452(d) of Title 10 of the United States Code, plus

(c) The total amount, if any, excludable from income under section 101(b)(2)(D) and paragraph (a)(2) of § 1.101-2 with respect to a survivor annuity provided by such retired or retainer pay, minus

(d) The total amount, if any, excluded from income before January 1, 1966, pursuant to the provisions of section 72 (b) and (d) with respect to a survivor annuity provided by such retired or retainer pay.

(iv) In determining whether there has been a recovery of the "consideration for the contract" under subdivision (i) of this subparagraph, the exclusion of retired pay from income after December 31, 1965, under sections 104(a)(4) and 105(d) shall not be considered as recovery of all or part of the "consideration for the contract."

(c) *Special rules.* In any of the following situations, the computation of